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Rep. Matt Pierce
Rep. Joseph Micon
Rep. Michael Murphy
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Rep. Randy Borrer



INTERIM STUDY COMMITTEE ON MORTGAGE LENDING PRACTICES AND HOME LOAN FORECLOSURES

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MEETING MINUTES¹

Meeting Date: September 13, 2007
Meeting Time: 10:00 A.M.
Meeting Place: State House, 200 W. Washington
St., Senate Chambers
Meeting City: Indianapolis, Indiana
Meeting Number: 2

Members Present: Sen. Connie Lawson, Chairperson; Sen. Greg Walker; Sen. Timothy Lanane; Sen. Richard Young; Rep. Jeb Bardon, Vice-Chairperson; Rep. Matt Pierce; Rep. Joseph Micon; Rep. Michael Murphy; Rep. Randy Borrer.

Members Absent: Sen. Allen Paul; Sen. Frank Mrvan; Rep. Woody Burton.

Senator Connie Lawson, Chair of the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures, called the meeting to order at 10:10 a.m. Senator Lawson announced that the meeting's agenda would include a discussion of: (1) mortgage fraud; and (2) regulation of the various professionals involved in residential real estate transactions.

¹ Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of \$0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is <http://www.in.gov/legislative/>. No fee is charged for viewing, downloading, or printing minutes from the Internet.

(1) Mortgage Fraud:

A. Defining the scope of the mortgage fraud problem:

David Miller, Legislative Consultant for the Office of the Attorney General, spoke to the Committee about the difficulty of determining the scope and extent of mortgage fraud in Indiana. He explained that mortgage fraud is one of several factors contributing to Indiana's high foreclosure rate. Estimates of the percentage of foreclosures that involve mortgage fraud range from 5% to 13%. Mr. Miller explained that it is difficult to more precisely determine the role of fraud in foreclosures, because fraudulent schemes usually involve numerous players and transactions. Because of the complexity of many mortgage fraud schemes, the prosecution of these cases is challenging. However, Mr. Miller noted two cases pursued by state attorneys general that resulted in settlements for consumers. Both cases involved deceptive practices by mortgage lenders. In 2002, Household International, Inc., agreed to pay \$484 million to the states to settle claims that its lenders misrepresented various loan terms. This settlement was followed by a \$295 million settlement involving Ameriquest Mortgage Company in 2006. As part of this settlement, Ameriquest agreed to make substantial reforms to its lending practices.

B. Enforcement of mortgage lending laws:

Gabrielle Owens, Director of the Homeowner Protection Unit (HPU) in the Office of the Attorney General, reported that with the funding made available through the Home Owner Protection Unit Account, the HPU has hired special staff to investigate real estate appraisers and other real estate professionals suspected of fraudulent activity. She indicated that the hiring of these skilled investigators was necessitated by the multiple properties and multiple players involved in the typical mortgage fraud scheme. According to Ms. Owens, among the various participants in fraudulent schemes, real estate appraisers are often key players. She reported that in 2006-2007, the Office of the Attorney General filed over 250 complaints against licensed appraisers. Ms. Owens then described a typical mortgage fraud scheme, noting the role that inflated appraisals play in allowing the participants to obtain mortgage loans that far exceed the true value of the properties involved.

Ms. Owens explained that in a typical scheme, one or more "promoters" buy a home in a foreclosure sale, or at an otherwise discounted price, and then collude with an appraiser to obtain an inflated appraisal of the property after the purchase. The promoters then enlist a person with a good credit history (and who is often unaware that the appraisal has been inflated) to take out a mortgage in the amount of the inflated appraisal. In exchange, the promoters often promise the person that they will make the mortgage payments on the person's behalf or find renters for the property. The proceeds of the mortgage provide cash to the promoters, who as the "sellers" in the new transaction, reap a windfall after having originally purchased the property for much less. Typically, the participants target out-of-state lenders that have little knowledge of the particular housing market. If the promoters fail to make good on their promise to pay off the new mortgage, the lender is stuck holding a mortgage on a property that is worth much less than the amount of the loan, and the person who obtained the loan is left with a damaged credit history.

Ms. Owens also pointed out that fraud can occur even after a property has entered foreclosure, as recognized by the legislature through the enactment SEA 390 (2007). Ms. Owens reminded the Committee that SEA 390 imposes certain restrictions and requirements on "foreclosure consultants," who solicit homeowners with offers to prevent or postpone a foreclosure proceeding, or who offer to purchase a home in a foreclosure sale and then resell or rent the home to the homeowner. She explained that the new law

allows the Attorney General to prosecute a violation of the act as a deceptive consumer sale and provides a cause of action for affected homeowners. The act further creates the crime of mortgage rescue protection fraud, a Class A misdemeanor. Ms. Owens reported that the Attorney General has used the new law to file a complaint against a foreclosure consultant in a case involving 37 consumers.

C. Proposed legislation:

Matt Light, Deputy Attorney General for the Consumer Protection Division, outlined a proposal for a comprehensive mortgage fraud statute. He explained that the statute would have three main sections: (1) a section defining several loan-related terms; (2) a section prohibiting specific fraudulent actions in mortgage transactions; and (3) a section setting forth enforcement mechanisms and penalties. According to Mr. Light, the "definitions" section would include "mortgage lending process" as a defined term, as well as a number of other terms related to mortgage lending. The "prohibitions" section would include a "laundry list" of prohibited acts, such as appraisal fraud, loan flipping, and promoting a fraudulent scheme. Finally, the "enforcement" section would have three components: (1) a cause of action for the Attorney General against violators, including the right to impose civil penalties; (2) a private cause of action for aggrieved parties; and (3) criminal penalties.

After Mr. Light had described the recommended legislation, Representative Borror asked whether the Attorney General's Office had found existing state law to be inadequate in any particular cases. Mr. Miller answered on behalf of the Office, explaining that existing law does not cover all of the players in a typical mortgage fraud scheme. In several cases, the Office has had to rely on general criminal statutes, such as theft or conversion statutes. Mr. Miller argued that more specific offenses need to be defined, and that enhanced penalties are required to deter fraudulent practices.

D. Prosecuting complicated mortgage fraud schemes:

Donna Eide, former Assistant United States Attorney for the Southern District of Indiana, and Co-Chair of the Indiana Mortgage Fraud and Foreclosure Prevention Task Force (Task Force), described the complexity of prosecuting cases involving mortgage fraud. First, however, she commented on the extent of the problem. While acknowledging that it is impossible to determine a precise percentage of mortgage foreclosures that involve fraud, Ms. Eide argued that mortgage fraud is pervasive in Indiana, especially in Indianapolis. She estimated that of the 9,000 foreclosure filings in Marion County in 2006, fraud may have been a factor in up to 25% of the cases. She reported that Center Township, in particular, has been targeted by these schemes, resulting in abandoned properties that remain vacant as they repeatedly change ownership. Because many of the investors in these properties eventually declare bankruptcy when they are no longer able to juggle multiple mortgage payments, Ms. Eide surmised that mortgage fraud could be a significant factor contributing to the high bankruptcy rate in Marion County.

After describing the nature and scope of the mortgage fraud problem, Ms. Eide turned to the challenges of prosecuting such fraud. Having prosecuted over 50 people involved in mortgage fraud schemes, Ms. Eide reported that 10 to 20 people are typically charged in connection with a scheme, including brokers, appraisers, and title agents. She noted that a mortgage fraud case can take over four years to prosecute, given the need to trace a series of transactions, subpoena numerous documents, and then prove the fraud beyond a reasonable doubt to a jury. Once a case finally does reach a jury, the jury is often overwhelmed by the amount and complexity of the evidence. The entire process is further hampered by the lack of resources available at both the federal and state levels to investigate and prosecute these cases.

Ms. Eide argued that the scarce resources available should be directed to preventing fraud, rather than prosecuting fraud after it occurs. She suggested that legislators focus on licensing requirements and background checks for appraisers, brokers, title agents, and other real estate professionals to ensure that criminals are not licensed in the first place. Regulatory agencies should also have the authority to summarily suspend licenses when fraudulent activity is suspected.

Senator Walker asked Ms. Eide whether it would be possible to conduct periodic field audits of licensed appraisers. Ms. Eide responded that such audits would be costly and time consuming. Noting that most of the appraisers involved in fraudulent schemes are in fact licensed, she maintained that more attention needs to be focused on screening applicants for initial licensure.

Senator Lanane asked whether the lenders that provide loans based on inflated appraisals are unsophisticated or just fail to exercise due diligence. Ms. Eide responded that the promoters of a scheme usually target out-of-state lenders, who have little knowledge of the local housing market, and who base their lending decisions on the documents provided to them.

E. Legislative proposals to combat mortgage fraud:

Gary Avery, Vice President of First Republic Mortgage Corporation and Co-Chair of the Task Force, offered a number of suggestions for legislation to combat mortgage fraud. First, however, he described the work and findings of the Task Force, which has met regularly for three years to devise solutions to the problems of mortgage fraud and foreclosures. Mr. Avery explained that the Task Force is comprised of realtors, builders, mortgage brokers, bankers, appraisers, and mortgage bankers. Through its discussions with both the professionals involved in the mortgage lending process and the agencies that regulate them, the Task Force has reached the following conclusions: (1) The regulatory process is fragmented due to the involvement of several different state agencies. (2) There are no requirements for the agencies involved to collaborate or otherwise share information. (3) There is often a duplication of efforts among agencies, resulting in wasted resources. (4) There is little continuity or consistency in enforcement efforts.

Having reached these conclusions, the Task Force considered legislative, administrative, and educational solutions to the problems it discovered. Mr. Avery shared the following proposals generated by the Task Force: (1) Require all deeds transferring title to residential real estate to include the sales price, the full name and signature of the buyer, and the names and license numbers of all professionals involved in the transaction. (2) Require out-of-state lenders to register with the state before offering loan products to Indiana consumers. (3) Require all licensing fees to be set aside for enforcement efforts and consumer education initiatives. (4) Establish a statewide database containing essential information on all residential real estate transfers in Indiana. (5) Establish a statewide real estate fraud hotline to allow the reporting of suspected fraud. (6) Require all real estate professionals licensed or regulated by state agencies to undergo a national criminal history background check.

Mr. Avery also discussed a more controversial proposal to merge into a single Department of Real Estate all the agencies that currently regulate the various professionals. He explained that he and Donna Eide had developed this concept as a way to streamline the regulatory process and to avoid duplication of efforts by different state agencies.

(2) Regulation of Residential Real Estate Transactions:

A. Regulation of loan brokers:²

O. Wayne Davis, Securities Commissioner for the Office of the Indiana Secretary of State, discussed recent changes to the regulation of loan brokers and originators through the enactment of HEA 1717 (2007). He explained that the new law gives additional authority to the Securities Commissioner to take certain enforcement actions against brokers, originators, and principal managers. He indicated that the Securities Division would propose additional legislation for the 2008 session to enable national criminal history checks by the FBI for all applicants for licensure or registration.

Mr. Davis acknowledged that there is some duplication of effort among the various state agencies involved in regulating real estate transactions. However, he maintained that the formation of a centralized Department of Real Estate would lead to a larger bureaucracy that would not have the focus or "nimbleness" of the individual agencies that currently regulate residential real estate transactions. He predicted that a centralized agency would be organized into departments, with no guarantee that the departments would collaborate any more by virtue of falling within the same agency. Mr. Davis argued that the existing agencies already collaborate and exchange information on an "operational level," making a restructuring of government unnecessary.

Looking forward, Mr. Davis suggested that the existing loan broker law could be amended to require originators to consider the suitability of a loan product for a prospective borrower before procuring the loan on the borrower's behalf. For example, the statute could require an originator to consider a prospective borrower's income, expenses, assets, liabilities, and credit history in determining whether a particular loan is suitable for the borrower. Mr. Davis further predicted that reverse mortgages will replace subprime loans as the product of concern for regulators. He noted that such loans provide payments to homeowners based on the equity in their homes and do not have to be paid back for as long as the homeowner lives in the home. These loans are targeted to senior citizens, who often have built significant equity in their homes and need additional income after retiring.

Representative Bardon asked Mr. Davis about how the Securities Division uses the money that it receives through settlements or enforcement actions. Mr. Davis replied that any civil penalties the Division receives from enforcing the loan broker statute are paid into the Securities Division Enforcement Account for use by the Division in administering the Uniform Securities Act and for investor education and financial literacy initiatives. Money that is received in legal settlements is returned to the parties who are victimized by a particular violation.

Returning to the proposal for a Department of Real Estate, Representative Pierce suggested that by housing all regulators in close, physical proximity to one another, a consolidation would facilitate communication and information sharing. Mr. Davis replied that with only 26 employees currently in his office, he still has to have procedures in place to ensure information sharing just among his own staff.

B. Regulation of lenders:³

Judith Ripley, Commissioner of the Department of Financial Institutions (DFI), explained that her agency is responsible for regulating state-chartered depository institutions. In

²See Exhibit 1.

³See Exhibit 2.

addition, the DFI oversees 285 non-depository lenders under the Uniform Consumer Credit Code. However, Ms. Ripley pointed out that the DFI does not have statutory authority to regulate non-depository lenders that issue first mortgages on property. Ms. Ripley noted that Indiana is one of the few states that does not regulate non-depository first mortgage lenders and urged legislators to consider giving the DFI the authority to do so.

Ms. Ripley reported that both the DFI and the Securities Division have signed on to participate in the National Mortgage Licensing Database established by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators. The national database is set to go online in January 2008 and will allow the DFI to check the qualifications, background, and licensing status of lenders. To date, thirty-nine other states have agreed to participate.

Ms. Ripley also reported that the CSBS has proposed a two-page disclosure statement that would provide prospective borrowers with essential, timely information in a summary format before the real estate closing. Ms. Ripley encouraged legislators to require that such a disclosure be given to Indiana consumers.

Senator Lawson asked Ms. Ripley to comment on the proposal for the creation of a Department of Real Estate. Ms. Ripley suggested that the availability of the nationwide licensing database will bring uniformity to the regulatory process and may make the proposed reorganization unnecessary. However, she did allow that the proposal is worthy of further study and expressed support for Mr. Avery's suggestion that certain information be included on residential real estate deeds.

C. Regulation of title insurance agents:⁴

Carol Mihalik, Chief Deputy of the Consumer Protection Unit (CPU) in the Indiana Department of Insurance, testified about the regulation of title insurance agents and title insurance companies. Ms. Mihalik reported that of the 120,000 licensed insurance producers in Indiana, approximately 3,300 are title agents. Of the 2,000 insurance companies doing business in Indiana, less than 20 are solely engaged in the title insurance business. While title insurance agents and title insurance companies represent a small percentage of the state's regulated insurance entities, they are engaged in specialized transactions that require specialized oversight. In recognition of the need for experienced regulators to oversee these companies and individuals, the Title Insurance Division was established within the CPU in April 2007. Ms. Mihalik explained that the Division is staffed by two attorneys and two field examiners and is funded through the Title Insurance Enforcement Fund. Established by the legislature in 2006, the Fund consists of fees paid by purchasers of title insurance policies. For each policy sold, a \$5.00 fee is assessed, \$3.00 of which is deposited in Fund, and \$2.00 of which is retained by title insurers as an administrative fee.

Senator Lawson again asked for comment on the proposal for a consolidated Department of Real Estate. Ms. Mihalik responded that information sharing among agencies and law enforcement is more crucial than the formation of a single department. She expressed support for the establishment of a database that would house information on mortgage fraud cases, and that could be accessed by regulators and law enforcement agencies throughout the state. She also indicated that it would be helpful to the Department of Insurance to have law enforcement authority to pursue criminal actions against title insurance agents and companies involved in fraud.

⁴See Exhibit 3.

D. Regulation of real estate appraisers:⁵

Wade Lowhorn, Deputy Director for the Indiana Professional Licensing Agency (IPLA), discussed the regulation of real estate appraisers. By way of background, he explained that the IPLA provides administrative support for 38 professional licensing boards and commissions, including the Indiana Real Estate Commission (Commission) and the Real Estate Appraiser Licensure and Certification Board (Board). Real estate appraisers are regulated by the Board, which in turn falls under the jurisdiction of the Commission. The Board consists of seven governor-appointed members, including five licensed or certified appraisers, one lender, and one consumer. In addition, eight full-time IPLA employees work directly with the Commission, the Board, and the Home Inspectors Licensing Board.

Indiana's real estate appraiser regulatory program is also subject to federal oversight under Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Mr. Lowhorn explained that FIRREA required states to create a licensing and certification program for real estate appraisers. Only appraisers who are licensed or certified by a state program may be used in real estate transactions regulated by one of the federal financial institutions regulatory agencies. FIRREA further authorized the Appraisal Subcommittee (ASC), a government agency consisting of representatives from the federal financial institutions regulatory agencies and the U.S. Department of Housing and Urban Development (HUD). Funded through a surcharge on state licensing fees, the ASC conducts periodic field reviews of each state's regulatory program and maintains a national online registry of all licensed and certified appraisers.

Mr. Lowhorn noted that the Board recently adopted rules to establish more stringent qualifications standards for licensing and certification, as mandated by the federal government. These rules will take effect on January 1, 2008, and will increase the educational requirements for licensure and certification.

Under Indiana's regulatory program, there are currently 3,113 appraisers with active licenses or certifications. Although these professionals represent only 0.7% of all active licensees regulated by the IPLA, appraisers have accounted for 25.3% of disciplinary cases brought against all licensees since January 2006. However, Mr. Lowhorn explained that the number of disciplinary cases brought against appraisers has increased due to recent legislation that has given IPLA increased authority to investigate and take enforcement action against real estate appraisal fraud. For example, in 2005, the legislature increased the licensing surcharge that funds the Real Estate Investigative Fund from \$10 to \$20. The increased surcharge generates about \$500,000 per year for the Fund, the proceeds of which are shared by the Attorney General and the IPLA for investigative and enforcement activities. However, Mr. Lowhorn noted that the relevant statute specifies that if the amount in the Fund exceeds \$750,000, the amount above that threshold reverts to the State General Fund. Mr. Lowhorn urged legislators to amend the law to allow all money to remain in the Real Estate Investigative Fund to further enhance the enforcement capabilities of the two agencies.

Representative Bardon asked whether appraisers are required to undergo criminal background checks. Mr. Lowhorn indicated that criminal background checks are not currently required. However, he cautioned that legislation to mandate such checks would have a fiscal impact on both the IPLA and the Indiana State Police. Senator Lawson agreed that ISP is not equipped to handle the requests for criminal background checks that it currently receives. She suggested that any proposal to require such checks for

⁵See Exhibit 4.

appraisers would have to be phased in gradually.

Representative Murphy then asked Gabrielle Owens about the types of complaints against appraisers that the Attorney General's Office receives. Ms. Owens responded that most complaints involve inflated appraisals, with a vast array of allegations within that category. She reported that in 2006-2007, the Office received 215 complaints against appraisers, five of which involved summary suspensions of an appraiser's license or certification, and 88% of which resulted in penalties.

E. Centralized regulation:

Senator Lawson allowed Donna Eide a final opportunity to clarify and summarize her proposal for the creation of a centralized agency to regulate various real estate professionals. Ms. Eide reiterated that the proposal for a Department of Real Estate did not originate from the Task Force. Rather, it represents an idea that she and Gary Avery conceived from their work together on the Task Force. Rejecting claims that a single agency would become fragmented into disparate groups, Ms. Eide urged legislators to further consider the concept as they complete their study.

Before the meeting's conclusion, Representative Murphy announced that he had distributed several articles about mortgage foreclosures to members of the Committee.⁶ He noted that one of the articles describes the high number of foreclosures in Franklin Township, an area in his Indianapolis legislative district.

There being no further testimony, Senator Lawson adjourned the meeting at 2:50 p.m.

⁶See Exhibit 5.